Interest Rate Risk Management Weekly Update

March 30, 2015

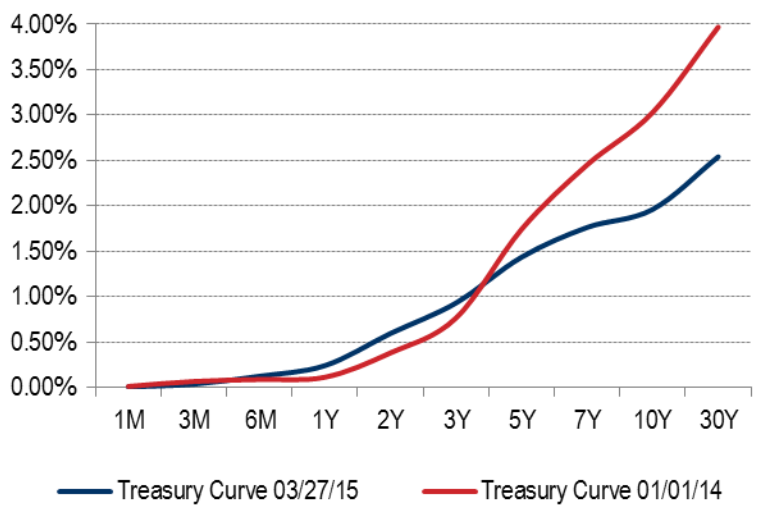
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change	
1-Month LIBOR	0.18%	0.17%	0.01%	↑
3-Month LIBOR	0.28%	0.27%	0.01%	↑
Fed Funds	0.25%	0.25%	0.00%	○
Fed Discount	0.75%	0.75%	0.00%	○
Prime	3.25%	3.25%	0.00%	○
US Treasury Yields				
2-year Treasury	0.60%	0.58%	0.02%	↑
5-year Treasury	1.44%	1.42%	0.02%	↑
10-year Treasury	1.96%	1.93%	0.03%	↑
Swaps vs. 3M LIBOR				
2-year	0.88%	0.90%	(0.02%)	↓
5-year	1.63%	1.62%	0.01%	↑
10-year	2.10%	2.08%	0.02%	↑

Fed Speak & Economic News:

- With the first quarter of the year drawing to an end, we thought it might be useful to review what has happened thus far and provide a foundation for what to expect in the future. The major drivers of interest rates included currency movements, weaker energy prices, and subdued inflation levels and they are likely to play a major role going forward.
- The expected divergence in global economies – especially between that of the United States and other developed economies – did not materialize as many economists thought it would. A majority of market participants believed that the strength in the labor market would force the Fed's hand to begin interest rate normalization by mid-year but now the majority believes that timeline has been pushed back to the third quarter. The impetus for such a delay was the dramatic strengthening of the US dollar, although the Fed did not explicitly admit it. More specifically, the dollar's effects on inflation and the economy via import and export channels forced the Fed to downgrade its assessment of potential economic output for 2016 and 2017 at its most recent meeting in March. On the other hand, across the pond, the European Central Bank's launch of its very own quantitative easing program last month provided a much-needed boost to expected inflation levels and economic activity in the eurozone. The ECB was joined by other central banks in policy easing, such as the People's Bank of China, the Bank of Canada and the Swiss National Bank. With many central banks across the globe engaging in some form of monetary easing and the Fed on deck to tighten, it is not hard to see why the value of the dollar surged.
- Another factor that drove interest rates was the combination of subdued inflation and the lack of wage pressure, which has done well to keep the Fed very cautious as to when it should begin normalizing interest rates. This is especially true against a backdrop of disappointing growth in Japan, China, and other developed economies, as well as the decline in energy prices we witnessed during the first quarter. The strength of the dollar does not help in this situation either: Import levels decline, as a stronger dollar buys more goods, all else equal, while export growth weakens as our goods become more expensive to purchase for those living abroad.
- How the interest rate landscape will develop depends entirely on the evolution of inflation, which will in turn affect when the Fed tightens policy. The strength of the dollar adds another level of complexity and higher interest rates will only bolster that strength. However, if global economic growth picks up, bringing inflation along with it, a strong dollar is unlikely to prevent the Fed from hiking rates.

The Treasury Curve has Flattened in 2015



The chart to the left shows the flattening of the US Treasury curve since the beginning of the year. The front-end was driven higher by the expectation that the Fed would raise interest rates this year. The back-end was driven lower by subdued inflation and weaker energy prices, as well as the attractiveness of US yield levels. In other words, the back-end is lower because of the decline in the premium that investors demand for inflation risk.

The Week Ahead

- The US economic calendar will be loaded this week, with the most important being the March nonfarm payrolls report released on Friday.

Date	Indicator	For	Forecast	Last
30-Mar	Personal Income	Feb	0.3%	0.3%
30-Mar	Personal Spending	Feb	0.2%	0.2%
31-Mar	Consumer Confidence Index	Mar	96.4	96.4
31-Mar	Chicago Purchasing Manager	Mar	51.8	45.8
1-Apr	ISM Manufacturing	Mar	52.5	52.9
1-Apr	Markit US Manufacturing PMI	Mar F	55.3	55.3
1-Apr	ADP Employment Change	Mar	225k	212k
2-Apr	Factory Orders	Feb	(0.4%)	(0.2%)
2-Apr	Trade Balance	Feb	-$41.3B	-$41.8B
3-Apr	Change in Nonfarm Payrolls	Mar	245k	295k
3-Apr	Unemployment Rate	Mar	5.5%	5.5%

Sources: Bloomberg

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